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In the Matter of	)	
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	

COMMENTS OF
THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

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SUMMARY OF

COMMENTS OF THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

CC Docket No. 94-1 May 9, 1994

While the current price cap plan for the LECs has been successful in lowering prices and promoting the introduction of new services, the Commission now has the opportunity to introduce more flexible and adaptive policies. The Commission should eliminate regulatory obstacles and move beyond the current restrictions of the existing price cap plan. Then the true potential of the telecommunication's industry and the ability of the LECs to rapidly deploy a national information infrastructure will be enhanced. Regulatory policies should incent LECs to bring new services to the market, offering greater customer choice and the potential for stimulating economic growth.

In contrast to AT&T's price cap plan, the LEC price cap plan began as a simple concept but has become increasingly more complex. LEC pricing is constrained as newly created bands and sub-bands further inhibit needed flexibility. The Commission should modify its rules on introducing new services and repackaging services for the LECs to be more responsive to customers' needs.

Distinctions between elective and mandatory price cap LECs should be retained. SNET chose price cap regulation because it provided incentives to become more efficient and promised reduced administrative burdens required under rate of return regulation. Fairness dictates that the choice of price cap regulation be linked to stability in the plan's incentives. An increase in the productivity offset would be inappropriate. Nor is it necessary to increase reporting burdens. The Commission should subject any additional reporting requirements to cost benefit analyses and sunset provisions should be considered. Market forces continue to be the most effective means of insuring service quality.

The introduction of new services should not be constrained. Improved capital recovery mechanisms, increased pricing flexibility and streamlined filing and cost support procedures are needed. Tariffing restrictions on the LECs should be eliminated including banding, and separate categories for DS1 and DS3 services.

SNET's markets are currently subject to competition from Competitive Access Providers (CAPs). The current basket and band structure should be restructured to permit increased pricing flexibility tied to the level of competition in the market. For competitive services, LECs should be permitted the same pricing flexibility as their competitors.

The Commission should conclude that the LEC price cap plan has worked well, combining public interest benefits with incentives for investment and innovation. Transitional policies and rules would remove the current disincentive aspects for innovation -- particularly for new services and repackaged existing services. The Commission should embrace a flexible framework to accommodate technological changes, competition and market demands.

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COMMENTS OF
THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

The Southern New England Telephone Company (SNET) submits its Comments in response to the Federal Communications Commission's (Commission) Notice of Proposed Rulemaking (NPRM)[1]

1. INTRODUCTION.

In its NPRM, the FCC seeks comments on its scheduled fourth year review of the price cap plan for local exchange carriers (LECs). The Commission's stated purpose is to consider whether the LEC price cap plan should be revised to better serve the goals of the Communications Act and the public interest.[2] SNET agrees with the Commission that the basic goals

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[1] Notice of Proposed Rulemaking, CC Dkt. No. 94-1, released February 16, 1994 (NPRM).

[2] NPRM at para. 4.

of price cap remain valid,[3] but the implementation of the plan needs to be refined because of the changing conditions in the telecommunications industry.

II. IMPROVEMENTS TO THE CURRENT PRICE CAP PLAN WOULD PROMOTE EFFICIENCY AND INNOVATION.

Under incentive regulation, prices have been lowered and service quality and universal service goals have not been compromised. While the existing price plan has yielded public interest benefits, substantial changes are necessary if the plan is to achieve the Commission's goals in the future.[4]

With increasing competition in access markets, the Commission should eliminate regulatory obstacles and move beyond the current restrictions of the price cap plan.[5] Modifications to the regulatory framework should preserve the incentives of the LECs to continue to bring new services to the market, offering greater customer choice and the potential for stimulating economic growth. Then the price cap plan can continue to play a role in support of the Commission's universal service goals, with telecommunications services more widely available at affordable prices.

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[3] "The lower prices and improved services generated by price caps should continue to benefit consumers." See NPRM at para 33.

[4] The Commission cited the benefits enjoyed under telephone price caps in its recent order on Cable Rate Regulation. See Second Order on Reconsideration, Fourth Report and Order and Fifth Notice of Proposed Rulemaking, MM Docket No. 92-266, released March 30, 1994 at para. 24. (Cable Order on Recon.)

[5] Commissioner Barrett's separate statement to NPRM at page 1.

The LEC Price Cap Plan is More Complex than AT&T's Simpler Plan.

In contrast to AT&T's Price Cap Plan, the LEC Price Cap Plan is closely tied to cost-based rate of return regulation and has increased in complexity over time.[6] For example, AT&T's plan never contained a sharing requirement yet it afforded greater pricing flexibility from its start. In contrast, the LEC plan requires time-consuming cost showings in support of new services and other requirements[7] making it difficult to respond quickly to customer needs. Moreover, pricing has become more constrained as freshly created service bands and sub-bands further inhibit flexibility.[8]

Distinctions Between Elective and Mandatory Price Cap LECs Should Be Retained.

Any revisions to the price cap plan should retain the Commission's current recognition that small and mid-sized elective price cap companies are fundamentally different from the large mandatory price cap LECs.[9] SNET elected price cap regulation in 1991 because of its promise of streamlined price regulation and fewer administrative burdens than rate of return regulation.[10] In choosing an incentive based system of regulation, SNET

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[6] See "Beyond Price Caps: Escaping the Traditional Regulatory Framework," speech by Commissioner Andrew C. Barrett to The Florida Economic Club, August 27, 1992, at page 1. (Barrett Speech).

[7] Waivers of the Commission's Part 69 rules are necessary because of the current inflexible regulatory structure. Long notice periods also burden the LECs unduly in an increasingly competitive marketplace. (Baseline Issue 8).

[8] In establishing a price cap plan and its basket structure for the cable industry, the Commission recognized the importance of efficiency and economic viability in the introduction of new services. See Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-215 and CS Docket No. 94-28, released March 30, 1994, at footnote 562. (Cable Report and Order).

[9] SNET is a single state LEC and lacks the scale and scope of multi-jurisdiction LECs.

[10] In describing a properly designed price cap plan for the cable industry, the Commission stated that such a plan "should also reduce regulatory burdens." See Cable Report and Order, at para. 299.

assumed risk beyond that of a rate of return company. Modifications to the price cap plan should not thwart the two key reasons that SNET opted for Price Caps: 1) Price Caps provided incentives to become more efficient and allowed the retention of the benefits of cost saving initiatives, and 2) Price Caps reduced the administrative burdens required under rate of return regulation.

Reporting Requirements Should be Subject to Cost Benefit Analysis and Sunset Provisions.

The Commission has continually added to the complexity of the price cap plan in the tariff administration area, and in service quality reporting. It continues to require extensive reporting of historical cost information,[11] in spite of its stated goal to reduce regulatory burdens.[12]

Fairness dictates that the choice of price cap regulation be linked to stability in the incentives offered by the plan. To properly motivate elective price cap LECs to adopt new technologies, to invest and to introduce new services, it is inappropriate to fine-tune the parameters of the price cap plan, such as an increase in the productivity offset.[13] Nor is it necessary to increase the reporting burden on elective price cap LECs (e.g., for service

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[11] The Commission continues to require all price cap LECs, whether they elected price caps or not, to file numerous Automated Reporting Management Information System (ARMIS) reports as well as the Cost Allocation Manual.

[12] NPRM at para. 12.

[13] Baseline Issue 3.

quality), particularly given the Commission's acknowledgment that there has been no service degradation under price caps.[14] Market forces continue to be the most effective means for insuring service quality. Continuing burdensome regulatory oversight consumes resources that can be better utilized to serve customers. Reporting requirements should be subject to a strict cost benefit analysis and should be imposed only where a demonstrable benefit can be shown. The Commission should consider a "sunset" provision with a reporting requirement being eliminated after a specified period of time.

III. COMPETITION AND RAPID TECHNOLOGICAL CHANGE REQUIRES REGULATORY REFORM

The Commission has continued to act to expand customer choice and open telecommunications markets to competition.

The Commission's decisions requiring expanded interconnection and collocation, and implementation of 800 data base technology have radically changed the regulatory framework.[15] At the same time, the convergence of voice, data, and video services, offered by a variety of landline and spectrum-based providers, have increased competition in the marketplace.

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[14] NPRM at para. 29.

[15] NPRM at para. 20.

Price Cap Regulation Should be More Adaptive and Flexible

Flexible regulatory policies are needed that recognize the impact of accelerating technological change.[16] Public policies must be forward-looking, rather than focused on market and technological developments of the past. As the Commission has recognized, because of competition in these converging industries, companies must be allowed to make decisions based on the impact of serving customers and not be forced to make decisions which reflect a set of non-market driven constraints.[17] Market forces will overwhelm companies who do not or cannot respond to the demands to the market when there are other customer choices.

As evidence of the need for "even-handed regulatory policies" due to the convergence of technologies and markets, the Commission's recent order on mobile services stated:[18]

> "Competitors providing identical or similar services will participate in the marketplace under similar rules and regulations. Success in the marketplace thus should be driven by technological innovation, service quality, competition-based pricing decisions, and responsiveness to consumer needs - and not by strategies in the regulatory arena. This even-handed regulation, in promoting competition, should help lower prices, generate jobs, and produce economic growth."

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[16] See Separate statement by Dr. Robert G. Harris, University of California, Berkeley and Law & Economics Consulting Group, Inc. Attachment 2 to the USTA Comments, CC Docket No. 94-1, filed May 9, 1994, pages 4-9. (Harris Report).

[17] See Cable Order on Recon. at para. 58.

[18] Second Report and Order, GN Docket No. 93-252, released March 7, 1994, at para. 19.

SNET believes that the principles articulated by the Commission for mobile services should also apply to common carriers, including LECs.

The Commission should remove regulatory impediments to competition in access markets. By taking full account of the dynamic changes in telecommunication, the Commission can achieve the goal of efficient regulation by moving towards pure price cap regulation. Then the need for sharing disappears and the incentives for efficiency and innovation can be more fully realized. The result of the adoption of price cap reforms can only benefit the US economy.

IV. PRICE CAP REGULATION HAS PROMOTED CONSUMER WELFARE AND ENCOURAGED CARRIER EFFICIENCY

Efficiency incentives under price cap regulation benefit consumers.

SNET agrees that the basic goals of price cap regulation remain valid, including rewarding carriers for becoming more efficient.[19] The Commission recognizes that the price cap LECs, including SNET, have continued to bring new services to the market, such as 800 data base,[20] to meet the diverse needs of customers. At the same time, customers have benefited from access rates lower than those in effect at the start of price caps.[21]

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[19] NPRM at para. 33.

[20] NPRM at para. 23. See Also SNET Tariff Filing No. 556, filed May 1, 1993.

[21] NPRM at para. 25.

The Commission recognizes that there is no deterioration in service quality as compared to before price caps.[22] Data monitored under price cap demonstrates that SNET remains dedicated to delivering high quality service.[23]

The development of advanced telecommunications infrastructure has the potential to foster economic growth and improve the quality of life.

Despite a weak Connecticut economy, SNET has made a commitment to continued infrastructure development. I-SNET, SNET's name for a statewide information superhighway, is consistent with the Administration's vision of a National Information Infrastructure[24] SNET intends to spend $4.5 billion over the next 15 years and strongly supports the Administration's efforts to encourage continued LEC investment in telecommunications infrastructure.[25] I-SNET will be an interactive multimedia communications network that holds the promise of attracting jobs, improving education, enhancing health care and fostering economic growth throughout the State of Connecticut.[26]

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22 NPRM at para. 9.

23 In addition, SNET has not reported any federal service complaints since its election to price caps. See Also NPRM at para. 27. (Baseline Issue 7).

24 NPRM at para. 3. (Baseline Issue 1).

25 Southern New England Telecommunications Corporation, 1993 Annual Report, at page 5.

26 Chairman Hundt and Vice President Gore have discussed the adoption of appropriate regulatory regimes encouraging technological innovation and business investment. FCC News Release No. 42281 dated March 22, 1994 "Chairman Hundt Addresses World Telecommunications Conference. Calls for An End to Isolation Through Telecommunications."

Universal service must continue to be advanced to avoid creating a society of information have and have-nots.

In Connecticut, the percentage of household's subscribing to telephone service has remained high. [27] For those households with limited means, SNET has worked with its state regulator in offering residential customers telephone connection assistance ("Link-Up America") and credits for Lifeline service.[28]

SNET is committed to the Commission's goal of promoting universal service to all geographic areas and of comparable type and quality for all Americans at affordable prices.[29] Regulators should remove barriers to efficient infrastructure deployment and incent investment decisions to promote the continued widespread availability of telecommunications services. Improved capital recovery mechanisms, increased pricing flexibility, and streamlined filing and cost support procedures would go far in accomplishing that goal. Where support mechanisms are required to insure universal service, the funding obligations should be competitively-neutral.

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[27] FCC CCB-Industry Analysis Division Report, "Telephone Subcribership in the United States," dated March 1994, at Table 2.

[28] SNET Letter date January 31, 1994 from A. MacClintock to P. Winns, Chief Industry Analysis Division, CCB, on Certification of State Lifeline and Link-Up America programs.

[29] NPRM at para. 34.

V. MARKETPLACE CHANGE REQUIRES MODIFICATION OF THE PRICE CAP PLAN

SNET's markets are currently subject to increased competition.

SNET's access services, particularly in major metropolitan areas, are subject to competition today.[30] For example, Metropolitan Fiber Systems and Access Transmission Services, Inc. (Western Union ATS) are currently able to provide access services in Connecticut. Other competitive access providers and CAT companies have announced significant investments in Connecticut to upgrade their facilities with fiber optics capable of two-way communications. Teleport has joined in a venture with three local CATV operators, Tele-Communications, Inc. (TCI), Comcast Corp. and Cox Cable Communications in the Hartford, CT area. In the future, it is also likely that wireless services will provide an alternative to LEC landline services. Changes to the existing price cap plan must recognize the change in the marketplace. Transitional mechanisms should link increased regulatory freedom with an increase in competition.

Further regulatory reform should embrace streamlined regulation and improved efficiency incentives.

In the face of substantial and increasing competition, the Commission should adopt regulatory policies that will a permit a smoother transition to a fully competitive telecommunications environment. Such an action is necessary if the Commission is to promote full and fair competition.

30 Transition Issue 1.

Fundamental change to the current basket and band structure is necessary to permit more streamlined and flexible regulation of LEC services.[31] The LEC price cap plan should be changed just as AT&T's price cap plan has been modified as competition has increased.[32] Such a restructuring to recognize the necessity of increased pricing flexibility should be tied to the level of competition in the market.[33]

The continued trend toward more intense competition should be recognized by the Commission by insuring that new price cap rules accommodate a wide array of market conditions and service alternatives. For competitive services, the Commission should permit LECs the same pricing flexibility as their competitors.

Regulatory oversight should not impede the LECs' ability to compete.

In response to the changes in the market due to competition and technology, the Commission's actions should be flexible enough to foster competition between market participants, yet create incentives for efficiency.[34] The Commission has recognized that "permitting flexibility in

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31 Baseline Issue 2.

32 NPRM at para. 37. (Baseline Issue 2).

33 Transition Issue 3.

34 See FCC Common Carrier Bureau Staff Working Paper on Access Charge Reform, released August 3, 1993, at pages 26 to 27.

price-setting generates economic efficiencies that benefit ratepayers through lower rates."[35]

Greater efficiency incentives can be provided through alternative incentive plans. LECs should be incented with sufficient financial rewards to induce the efficiency gains. Efficiency incentives must be sustained over a long enough period of time to be reflected in capital deployment decisions and fundamental marketing decisions.[36] Too frequent review of the price cap plan could diminish LEC incentives to innovate and undertake necessary infrastructure development.[37] SNET believes that a longer review period of at least five to six years is sufficient if the new price cap plan includes adequate incentives.

Pricing flexibility includes the ability to respond quickly to competition.

In its recent Cable Order, the Commission acknowledged the likelihood of competition in the marketplace and the convergence of services provided by telephone and cable companies.[38] While the Commission has taken steps to eliminate impediments to competition, geographic averaging of access

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[35] LEC Price Cap Order, 5 FCC Rcd 6786 (1990), CC Docket No. 87-313, released October 4, 1990, at para. 35.

[36] See "Regulatory Reform for the Information Age," prepared by Strategic Policy Research, Bethesda, MD, at pages 22 to 23. (January 1994) (SPR Report). (Transition Issue 5).

[37] NPRM at para. 99.

[38] The need for consistency in the price cap plans for the telecommunications and cable industry was recognized by the Commissions in its Cable Report and Order at para. 297.

charges and tariffing restrictions incorporating Part 69 rate structure categories make no economic sense.[39] Geographic averaging of access charges ignores differences in the cost of serving customers. Tariffing restrictions on the LECs are an example of asymmetric regulation that reduces the ability of a LEC to meet customer needs.[40]

Loosening the restrictions on LEC access pricing flexibility will bring the benefits of competition to customers and encourage economically efficient pricing. Such a plan should be sufficiently flexible to accommodate full competitive price responses. SNET believes that banding is no longer needed and should be eliminated; separate categories for DS1 and DS3 services are unnecessary; and that new services should be permitted as long as prices exceed incremental costs.

Recapture of past efficiency gains is inconsistent with the goals of incentive regulation.

A review of the results of price cap regulation for LECs does not support any need to increase the productivity offset.[41] In its review of the

[39] See Comments on the USTA Pricing Flexibility Proposal, prepared by Richard Schmalensee and William Taylor, at page 5.

[40] Implementation of tariff rules prevents LECs from meeting customer needs in a timely and predictable manner because 1) prices for access elements continue to reflect fully distributed costs, averaged over geographic areas and customers, and 2) LECs continue to be constrained from meeting competition from other access providers. See Schmalansee and Tayor at page 6.

[41] Modest earnings under price caps warrant neither an increase in the productivity offset factor nor a one-time adjustment in rates. (Baseline Issue 3).

AT&T price cap plan, the Commission did not change the offset.[42] In addition, the Commission's recently articulated cable productivity factor is significantly lower than the current 3.3% LEC productivity offset.[43] Stability in the offset measure is imperative to permit a LEC to benefit from success and respond to failure. SNET believes that as sufficient competition emerges, the productivity offset should be eliminated. As a minimum, elective price cap companies should have the option of selecting a productivity offset consistent with their achieved productivity.

Other proposed modifications in the price cap are unnecessary.

Changes in exogenous cost treatment should be rejected at this time.[44] As an elective price cap LEC, SNET understood that there was an opportunity for recovery of costs beyond the control of the company. Any change narrowing the potential for recovery would upset the balance between risk and reward under an incentive plan and should be rejected. Should the Commission eliminate the opportunity for exogenous cost recovery, SNET believes that it would be essential to liberalize other elements of the price cap plan to account for increased risk.[45]

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[42] Price Cap Performance Review for AT&T, CC Docket No. 92-134, Report released July 23, 1993, at para. 37.

[43] Cable Report and Order at para. 319.

[44] Baseline Issue 6.

[45] While SNET believes that exogenous cost treatment should be retained, its elimination would only be appropriate if balanced by other elements of the plan such as an increase in pricing flexibility or a reduced productivity offset.

VI. CONCLUSION.

Regulation should embrace a flexible framework to accommodate technological changes, competition and be responsive to market demands, while safeguarding the public interest. Rather than recommending an end to regulation, SNET is proposing regulatory policies that will provide for a smoother transition to a fully competitive environment. Such policies will promote economic welfare, allow LECs to compete on even terms and incent investment in the developing national information infrastructure.

Transitional policies and rules will be necessary to accommodate the rapidly evolving competitive landscape. Without appropriate flexibility, the true potential of the telecommunication's industry and the ability to rapidly deploy a national information infrastructure will be impaired.

Respectfully submitted,

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May 9, 1994

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CERTIFICATE OF SERVICE

I, Melanie Abbott, do certify on May 9, 1994, copies of the foregoing Docket No. 94-1 Comments of SNET were hand-delivered to the following:

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